

**TESTIMONY OF DOUG HARDY
MONTANA ELECTRIC COOPERATIVES' ASSOCIATION
ON SB 205**

**BEFORE THE HOUSE FEDERAL RELATIONS, ENERGY
AND TELECOMMUNICATIONS COMMITTEE**

March 9, 2011

I am Doug Hardy testifying today on behalf of the Montana Electric Cooperatives' Association.

This bill is a result of NorthWestern's concern regarding power supply in their service territory. We do, however, come before you as proponents of SB 205. The three reasons for our support are as follows:

1) Keeping our word.

By way of explanation of this point, I need to provide some brief legislative history.

In the 2001 legislative session, we strongly supported SB 325, which expanded rural electric cooperatives' powers and purposes and, further, established codes of conduct for rural electric cooperative trustees. A bill similar to SB 325 had been defeated in 1999 due to industry concern that we had more in mind than one could see by reading just the words of the bill. "Unintended consequences" was the catch-all phrase of the day even though our intentions then and now were strictly in accordance with the way the bill was worded.

A primary change in law allowed under SB 325 was an expanded definition of rural areas. In other words, the bill expanded the areas rural electric cooperatives would be authorized to serve.

SB 325 amended 35-18 of Montana Code Annotated, the statute under which electric cooperatives were authorized. Prior to the passage of SB 325, rural electric cooperatives could not serve in any areas of cities exceeding 3,500 in population. The only exception to that restriction was two cities that had always been served by electric cooperatives.

One statutory change needed in 2001 was to address Flathead Electric Cooperative's purchase of the poles and wires utility system of a public utility in Montana, PacifiCorp. In order to acquire this system, the co-op had to form a separate, non-cooperative entity to serve the non-rural areas, such as cities over 3,500. This included Kalispell, Whitefish and Columbia Falls, all of

which had formerly been served by PacifiCorp. Another change was to authorize formerly rural areas served by electric cooperatives that had been annexed by cities to continue service in those areas.

In part, SB 325 changed the rural definition to include those cities as areas in which electric cooperatives were authorized to serve. The change in law necessitated tightly written language. This was to prevent the change from affecting other cities like Missoula, Billings and Great Falls. We convinced the same industry folks that successfully bottled our 1999 bill up in committee that our motives were simply as the literal interpretation of the words in the bill intended.

As a result of this effort and our commitment, the suggestion now that a rural electric cooperative would be formed to serve areas outside the literal interpretation of "rural area" is of considerable concern to us because that was not the intent of the changes in our enabling legislation, MCA 35-18.

At the time SB 325 was passed, the customer choice law some call electricity deregulation, which was enacted in 1997, had a clause called reciprocity. This clause stated that if any utility (cooperative utility or public utility) wanted to opt into selling competitive power supply into another utility, they had to open their own utility system, allowing others to sell to its customers. Or, in the case of an electric cooperative, it would have had to open its own system to allow power to be sold to its members by another power supplier.

In 2007, HB 25 substituted the reciprocity provision in 69-8-411 MCA with language that allows any non-utility to sell to choice customers – that is, customers who have the ability to choose a power supply other than that of the utility. This provision applied only to what is now NorthWestern Energy because this was the only Montana electric utility that fully opened its system to offering choice of power supplier.

Because rural electric cooperatives are considered cooperative utilities in this section of code, we believe an REC utility is not authorized to provide power supply to NorthWestern choice customers such as ECP customers.

To sum up, keeping our word is a key reason for our support of SB 205 because it is consistent with the intent and, in some cases, our representations of previous changes in law. SB 205 makes that wording and intent even clearer.

- 2) SB 205 also enables RECs to maintain our professional ethics with NorthWestern Energy.

RECs are not afraid to go toe to toe with NorthWestern on issues where we have not previously agreed. We have, however, worked very hard over the years to replace a long-gone adversarial relationship in which we would go to battle over any little territorial dispute that arose.

We agreed to agree on what we agree with and to professionally disagree in areas we are not in agreement. As testament to this effort, we worked three years to reach a compromise agreement in 2007 on amendments to Montana's territorial integrity law. These changes reduced the conflicts between RECs and public utilities while providing more certainty to consumers requesting new service. The Legislature endorsed the changes and seemed quite relieved not to have to pick winners and losers between RECs and Public Utilities.

Largely as a result of these changes, there has been no litigation between RECs and NorthWestern since 2002, demonstrating commitment by both sides to go to great lengths to resolve rather than litigate. Professional ethics have saved electric ratepayers many dollars over recent years.

- 3) The positive impact across much of Montana enhancing the integrity of service territories through the passage of SB 205 is real. What do RECs gain and what do we lose?

In addition to maintaining our integrity and professional ethics, the gain is even more black and white language that further ensures when we contract for or build generation for the member consumers (premises) we serve, that we will be able to continue to provide power supply to those member customers.

Fourteen of the 25 rural electric distribution coops in Montana have power lines in proximity with NorthWestern Energy power lines. To the degree relations with NorthWestern degrade, causing each entity to look for creative interpretations of law to advantage itself, is the degree to which ratepayer dollars become wasted on litigation costs.

As a statewide association of rural electric cooperatives, it is MECA's responsibility to look at the impacts on each member cooperative prior to taking a position on a bill. It is a responsibility we take very seriously.

We are aware that Southern Montana Electric Generation and Transmission Cooperative and four of five of its distribution co-op members oppose this bill. In fact, all four of those distribution co-ops opposing the bill are also members of our association. We know Southern had suggested the formation of a rural electric cooperative utility to take the place of Electric City Power. Because of our concern about how the bill might affect those five co-ops that

are members of MECA, we went to great lengths investigating the ramifications of SB 205 on Electric City Power.

The conclusion we have reached after discussing SB 205 with Legislative Council, with counsel for the PSC and with our own legal counsel is that SB 205 does not affect their contracts. Based on their input, our further conclusion is that, short of very liberal interpretation of very prescriptive portions of law that would be inconsistent with intents and representations, a rural electric cooperative, whether legal to be formed or not, does not have the legal authority to sell power supply into a non-rural area or to Northwestern Energy's customers who have choice of power supplier.

In other words, as we see it, a rural electric cooperative cannot do today what SB 205 makes even more clear cannot be done. The greater clarity provided through passage of SB 205 avoids the peripheral damage and expenses of litigation and potential future bill requests for legislators to pick winners and losers.

Rather than being reactionary, SB 205 is proactive to clarify and reaffirm legislative intent of current law is in the eyes of the beholder.

We support the bill because it will prevent costly litigation and will protect the integrity of the service territories of both cooperative and public electric utilities.

MAXON R. DAVIS
GREGORY J. HATLEY
DENNIS J. TIGHE
PAUL R. HAFFEMAN
JAMES A. DONAHUE
JEFFRY M. FOSTER

LAW OFFICE OF
DAVIS, HATLEY, HAFFEMAN & TIGHE, P.C.
THE MILWAUKEE STATION, THIRD FLOOR
100 RIVER DRIVE NORTH
P. O. BOX 2103
GREAT FALLS, MONTANA 59403-2103

TELEPHONE
(406) 761-6243
FAX
(406) 761-4126
E-MAIL
max.davis@dhhtlaw.com

FILE NO: MECA

February 1, 2011

VIA E-MAIL

Gary Wiens
Assistant General Manager
Montana Electric Cooperatives' Association
501 Bay Drive
Great Falls, MT 59404

Re: *Service territory*

Dear Gary:

This letter responds to your request for my legal opinion, as legal counsel to the Montana Electric Cooperatives' Association, as to whether an electric cooperative organized pursuant to Chapter 18 of Title 35 of the Montana Code Annotated, can serve customers in the City of Great Falls.

My opinion is "No."

Chapter 18 of Title 35 is commonly known as the Rural Electric and Telephone Cooperative Act and provides the legal basis by which – to my knowledge – all of your Montana-based member cooperatives are organized.¹ It was originally enacted in 1939 as part of a nationwide movement of farmers and ranchers who organized member-owned cooperatives as a means of electrifying rural America, after the Neal Deal creation of the Rural Electrification Administration (the "REA," which is now known as the Rural Utilities Service or "RUS"). When President Roosevelt's New Dealers decided to get behind the idea of rural electrification, it was originally thought that federal subsidies from the REA would prove a sufficient incentive for existing investor-owned utilities to extend their lines into the countryside from their urban service territories. This proved not to be the case, so the idea of member-owned cooperatives caught on, as an alternative. Hence, many states besides Montana enacted legislation in the late 1930's as a means of ensuring that such cooperatives could be organized; those new electric cooperatives, which had gained an explicit statutory authorization, were then able to borrow funds from the REA to "turn the lights on" in rural America.

¹ MECA does of course have two Idaho-based cooperatives amongst its members. Those Idaho co-ops have service territories extending partially into Montana but each was organized under an Idaho statutory framework about which I readily claim no expertise.

This initiative was met with something besides passive acceptance by the existing investor-owned community, which was concerned that cooperatives receiving what were perceived as low-cost federal loans might not simply provide service in areas where the IOU's had declined to extend their lines, but also that the new co-ops would compete where the IOU's already existed, in cities and towns. Hence cooperative enabling legislation contained express restrictions on the geographic areas in which electric cooperatives could serve member/customers. In Montana, that tension found its expression in what are now §§ 35-18-102(6) and 35-18-105(1), MCA. The latter expressly provides that "cooperative nonprofit membership corporations may be organized under this chapter: (1) for the purpose of supplying electrical energy and promoting and extending the use of electrical energy in *rural areas*, as provided in this chapter." [Emphasis added] Section 35-18-102(6) in turn provides a very specific definition of "rural area":

(6) "Rural area", as applied to all corporations organized under the provisions of 35-18-105(1), means:

(a) an area not included within the boundaries of an incorporated or unincorporated city, town, village, or borough having a population in excess of 3,500 persons on March 17, 1939, or subsequent to March 17, 1939;

(b) an incorporated municipality in which 95% or more of the premises are served by an electric cooperative on February 1, 1971;

(c) a former rural area annexed by a municipality and subject to 69-5-109;
or

(d) an incorporated municipality that was served by a public utility that sold the public utility's distribution facilities within that municipality to an electric cooperative after January 1, 1998

The City of Great Falls is outside of the definition of a "rural area" under either §106(a), (b), (c) or (d). As to subsection (a), it is well known that Great Falls' population exceeded 3500 persons in 1939. As to subsection (b), the only electric cooperative serving members anywhere near Great Falls in 1971 was Sun River Electric Cooperative, Inc., for which I have served as legal counsel for the past twenty-five years. I can safely state that it did not serve 95% of the premises in Great Falls on February 1, 1971. Subsection (c) is likewise wholly inapplicable to the City of Great Falls. For it to apply, there needed to be an agreement entered into pursuant to § 69-5-109 between a co-op, i.e., Sun River, and Montana Power Co. or -- subsequently -- NorthWestern Energy pertaining areas annexed into the City of Great Falls. There is no such agreement. Lastly, for subsection (d), there needed to have been a sale by either Montana Power Company or NorthWestern of its Great Falls distribution facilities after 1998. There has been no such sale.

Subsection (d) merits one final comment. It was enacted by the 2001 Legislature. It was in fact enacted for the specific purpose of addressing the 1998 acquisition by Flathead Electric Cooperative, Inc., of PacifiCorp's service territories in Kalispell, Whitefish, Columbia Falls and Libby. That was a transaction in the \$100 million range. Obviously, it received tremendous scrutiny from Flathead's lenders. All concerned felt in 1998 that those service

Gary Wiens
February 1, 2011
Page 3

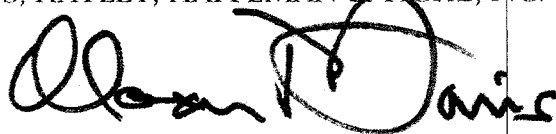
areas could not be immediately folded into the co-op, given that they did not otherwise qualify as "rural areas" under the Rural Electric and Telephone Cooperative Act. Accordingly, for the ensuing three years, those service areas were held by Flathead Electric in a separate, non-co-op corporate subsidiary. That subsidiary was only merged into the co-op itself after the addition of subsection (d) to § 35-18-102(6) in 2001.

That sequence of events stands as an implicit, yet altogether unmistakable, expression of the same view by others of the interpretation of the Rural Electric and Telephone Cooperative Act which I have provided to you. The City of Great Falls is not a "rural area" which a Montana electric cooperative organized and existing under Chapter 18 of Title 35 of the Montana Code Annotated is authorized to serve.

Very Truly Yours,

DAVIS, HATLEY, HAFFEMAN & TIGHE, P.C.

By

A handwritten signature in black ink, appearing to read "Alan P. Davis". The signature is stylized with a large, looping "D" and a prominent "A".

MRD:aab

CURRENT MONTANA RURAL ELECTRIC CO-OP UTILITY

ENABLING LAW

Pertinent Sections

35-18-102. Definitions. In this chapter, unless the context otherwise requires, the following definitions apply:

(1) "Broadband" means transmission facilities capable of handling frequencies greater than those required for high-grade voice communication, higher than 4 kilohertz.

(2) "Cable television system" means a system that receives and amplifies the signals broadcast by one or more television stations and redistributes the signals to subscribing members of the public for a fixed or periodic fee by wire, cable, microwave, or other means, whether the means are owned or leased.

(3) "Cooperative" means a corporation organized under this chapter or a corporation that becomes subject to the provisions of this chapter.

(4) "Member" means each incorporator of a cooperative and each person admitted to and retaining membership in a cooperative as provided by the articles of incorporation or bylaws of the cooperative, including persons admitted to joint membership.

(5) "Person" includes any natural person, firm, association, corporation, business trust, partnership, federal agency, state or political subdivision or an agency of a state or political subdivision, or other organization or group of persons.

(6) "Rural area", as applied to all corporations organized under the provisions of 35-18-105(1), means:

(a) an area not included within the boundaries of an incorporated or unincorporated city, town, village, or borough having a population in excess of 3,500 persons on March 17, 1939, or subsequent to March 17, 1939;

(b) an incorporated municipality in which 95% or more of the premises are served by an electric cooperative on February 1, 1971;

(c) a former rural area annexed by a municipality and subject to 69-5-109; or

(d) an incorporated municipality that was served by a public utility that sold the public utility's distribution facilities within that municipality to an electric cooperative after January 1, 1998.

History: (1)En. Sec. 2, Ch. 172, L. 1939; amd. Sec. 2, Ch. 80, L. 1957; amd. Sec. 9, Ch. 7, L. 1971; Sec. 14-502, R.C.M. 1947; (2)En. Sec. 30, Ch. 172, L. 1939; amd. Sec. 1, Ch. 151, L. 1949; amd. Sec. 9, Ch. 80, L. 1957; amd. Sec. 10, Ch. 7, L. 1971; Sec. 14-530, R.C.M. 1947; R.C.M. 1947, 14-502(part), 14-530; amd. Sec. 1, Ch. 237, L. 1979; amd. Sec. 1, Ch. 208, L. 1981; amd. Sec. 2, Ch. 168, L. 1987; amd. Sec. 2, Ch. 406, L. 2001.

35-18-106. Powers of cooperatives. (1) A cooperative may:

(a) sue and be sued in its corporate name;

(b) have perpetual existence;

(c) adopt a corporate seal and alter the seal;

(d) become a member in one or more other cooperatives or corporations or own stock in other cooperatives or corporations;

(e) construct, purchase, take, receive, lease as lessee, or otherwise acquire and own, hold, use,

equip, maintain, and operate and sell, assign, transfer, convey, exchange, lease as lessor, mortgage, pledge, or otherwise dispose of or encumber:

- (i) electric transmission and distribution lines or systems;
- (ii) electric generating plants;
- (iii) electric refrigeration plants;
- (iv) telephone lines, facilities, or systems (but not telegraph or radio broadcasting services or facilities) as defined by law;
- (v) lands, buildings, structures, dams, plants and equipment, and all kinds or classes of real or personal property that may be considered necessary, convenient, or appropriate to accomplish the purpose for which the cooperative is organized;
- (f) purchase or otherwise acquire and own, hold, use, and exercise and sell, assign, transfer, convey, mortgage, pledge, hypothecate, or otherwise dispose of or encumber franchises, rights, privileges, licenses, rights-of-way, and easements;
- (g) borrow money and otherwise contract indebtedness and issue notes, bonds, and other evidences of indebtedness and secure the payment of indebtedness by mortgage, pledge, deed of trust, or any other encumbrance upon all of its then-owned or after-acquired real or personal property, assets, franchises, revenue, or income;
- (h) subject to the requirements on the use of public thoroughfares and land that are imposed by the appropriate authority having jurisdiction over corporations constructing or operating electric transmission and distribution lines or systems or telephone lines, facilities, or systems, construct, maintain, and operate electric transmission and distribution lines or telephone, cable television, or broadband lines, facilities, or systems:
 - (i) along, upon, under, and across all public thoroughfares, including without limitation all roads, highways, streets, alleys, bridges, and causeways; and
 - (ii) upon, under, and across all publicly owned lands;
- (i) exercise the power of eminent domain in the manner provided in Title 70, chapter 30, for the exercise of that power by corporations constructing or operating electric transmission and distribution lines or systems or telephone lines, facilities, or systems;
- (j) conduct its business and exercise all of its powers within or outside of this state;
- (k) adopt, amend, and repeal bylaws; and
- (l) perform all other acts and exercise all other powers that may be necessary, convenient, or appropriate to accomplish the purpose for which the cooperative is organized or authorized under federal law.

(2) In addition to the powers listed in subsection (1), corporations organized under the provisions of 35-18-105(1) may:

- (a) generate, manufacture, purchase, acquire, accumulate, and transmit electrical energy;
- (b) distribute, sell, supply, and dispose of electrical energy in rural areas to:
 - (i) its members;
 - (ii) governmental agencies and political subdivisions; and
 - (iii) other persons not in excess of 10% of the number of its members;
- (c) make loans to persons to whom electrical energy is or will be supplied by the cooperative to assist those persons in wiring their premises and installing in their premises electrical and plumbing fixtures, appliances, apparatus, and equipment of all kinds and character;
- (d) in connection with electrical and plumbing fixtures, purchase, acquire, lease, sell, distribute, install, and repair the electrical and plumbing fixtures, appliances, apparatus, and equipment and accept or otherwise acquire and sell, assign, transfer, endorse, pledge,

hypothecate, and otherwise dispose of notes, bonds, and other evidences of indebtedness and all types of security for electrical and plumbing fixtures; and

(e) make loans to persons to whom electrical energy is or will be supplied by the cooperatives for the purpose of and otherwise to assist those persons in constructing, maintaining, and operating electric refrigeration plants.

(3) In addition to the powers listed in subsection (1), corporations organized under the provisions of 35-18-105(2) may:

(a) improve and expand existing telephone lines, facilities, and systems;

(b) construct, acquire, operate, and furnish additional telephone lines, facilities, and systems that are required to ensure the availability of adequate telephone service to the widest practicable number of users of telephone service;

(c) make loans to persons to whom telephone service is or will be supplied by the cooperative to assist those persons in wiring their premises for telephone service and installing in their premises telephone fixtures, appliances, apparatus, and equipment of all kinds and character;

(d) in connection with telephone fixtures, purchase, acquire, lease, sell, distribute, install, and repair the telephone fixtures, appliances, apparatus, and equipment; and

(e) accept or otherwise acquire and sell, assign, transfer, endorse, pledge, hypothecate, and otherwise dispose of notes, bonds, and other evidences of indebtedness and all types of security for telephone fixtures.

History: En. Sec. 3, Ch. 172, L. 1939; amd. Sec. 3, Ch. 80, L. 1957; R.C.M. 1947, 14-503; amd. Sec. 3, Ch. 237, L. 1979; amd. Sec. 2, Ch. 254, L. 1985; amd. Sec. 4, Ch. 168, L. 1987; amd. Sec. 2, Ch. 61, L. 1993; amd. Sec. 42, Ch. 7, L. 2001; amd. Sec. 31, Ch. 125, L. 2001.

CURRENT MONTANA LAW

NON-DISCRIMINATORY ACCESS FOR POWER SUPPLY

69-8-411. Nondiscriminatory access. (1) Nonutility generators and electricity suppliers must have open, fair, and nondiscriminatory access to a public utility's transmission and distribution facilities according to federal energy regulatory commission rules and regulations for purposes of serving those customers identified in 69-8-201(1) and (2).

(2) Public utilities shall grant the retail customers identified in 69-8-201(1) and (2) and their electricity suppliers access to transmission and distribution facilities at rates and under terms and conditions comparable to the public utility's own access to those facilities or access by the public utility's affiliates.

(3) Public utilities shall file tariffs for transmission and distribution services regulated by the federal energy regulatory commission and the commission implementing subsections (1) and (2).

History: En. Sec. 28, Ch. 505, L. 1997; amd. Sec. 4, Ch. 580, L. 1999; amd. Sec. 12, Ch. 491, L. 2007.